Office - Supreme Court, U.S.
FILED
NOV 17 1982
CLERK

No. 82-131

In the Supreme Court of the United States

OCTOBER TERM, 1982

JONES & LAUGHLIN STEEL CORPORATION, PETITIONER

v.

HOWARD E. PFEIFER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONER

REX E. LEE
Solicitor General

J. PAUL MCGRATH
Assistant Attorney General

KENNETH S. GELLER
Deputy Solicitor General

RICHARD G. WILKINS
Assistant to the Solicitor General

JEFFREY AXELRAD
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

The United States will address the following question:

Whether the court of appeals properly refused to discount to present value a damages award for lost future earnings on the assumption that inflation completely offsets the discount rate.

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statement	2
Summary of the argument	4
Argument:	
The "total offset" rule adopted by the court of appeals is contrary to sound economic theory and is an inaccurate method of calculating the impact of inflation on damages awards	5
Conclusion	17

TABLE OF AUTHORITIES

Cases:

Bach v. *Penn Central Transportation Co.*, 502 F.2d 1117 8-9
Barnes v. *United States*, 685 F.2d 66 ..... 2, 15
Chesapeake & O. Ry. v. *Kelly*, 241 U.S. 485 ..... 6, 7, 13, 15
Culver v. *Slater Boat Co.*, 688 F.2d 280 ..... *passim*
Doca v. *Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30, cert. denied, 451 U.S. 971 ..... 7, 8, 9, 10, 13, 14
Feldman v. *Allegheny Airlines, Inc.*, 524 F.2d 384 11
Freeport Sulphur Co. v. *S/S Hermosa*, 526 F.2d 300 14
Johnson v. *Penrod Drilling Co.*, 510 F.2d 234 7
Kaczkowski v. *Bolubasz*, 491 Pa. 561, 421 A.2d 1027 ..... 3, 4, 7, 16, 17
Morvant v. *Construction Aggregates Corp.*, 570 F.2d 626, cert. dismissed, 439 U.S. 801 ..... 8, 9
Norfolk & W. Ry. v. *Liepelt*, 444 U.S. 490 ..... 5-6, 12, 16
O'Shea v. *Riverway Towing Co.*, 677 F.2d 1194 ..... *passim*
Reed v. *The Yaka*, 373 U.S. 410 2
Riha v. *Jasper Blackburn Corp.*, 516 F.2d 840 ..... 8, 9
Russell v. *City of Wildwood*, 428 F.2d 1176 5
Steckler v. *United States*, 549 F.2d 1372 ..... 7, 8, 9
United States v. *English*, 521 F.2d 63 ..... 7-8, 9, 14
Williams v. *United States*, 435 F.2d 804 7

Statutes: Page

Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. (& Supp. IV) 901 *et seq.* 1
Section 5(a), 33 U.S.C. 905(a) 2
Section 5(b), 33 U.S.C. 905(b) 1, 2, 3
Federal Tort Claims Act:
28 U.S.C. 1346(b) 1
28 U.S.C. 2671 *et seq.* 1
28 U.S.C. 2674 2

Miscellaneous:

I. Fisher, *The Theory of Interest* (1930) 10, 13, 14
Note, *Considering Inflation in Calculating Lost Future Earnings*, 18 Washburn L.J. 499 (1979) .. 11, 13, 15, 17
128 Cong. Rec. S9213 (daily ed. July 27, 1982) 3
P. Samuelson, *Economics* (9th ed. 1973) 10
R. Posner, *Economic Analysis of Law* (1973) 10, 13, 14

In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-131

JONES & LAUGHLIN STEEL CORPORATION, PETITIONER

v.

HOWARD E. PFEIFER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF THE UNITED STATES

The United States has a direct interest in the proper interpretation and administration of the Longshoremen's and Harbor Workers' Compensation Act (LHWCA), 33 U.S.C. (& Supp. IV) 901 *et seq.* The refusal of the court of appeals in this case to discount to present value a damages award for lost future earnings results in an unwarranted windfall for plaintiffs under Section 5(b) of the LHWCA, 33 U.S.C. 905(b). The decision, moreover, may well have an impact on the computation of damages awards under other federal statutes, notably the Federal Tort Claims Act (FTCA), 28 U.S.C. 1346(b), 2671 *et seq.* Although damages awards under the FTCA are based

on state rather than federal law, the decision below, if affirmed by this Court, may well serve as precedent for state and federal courts deciding cases under the FTCA. See, *e.g.*, *Barnes* v. *United States*, 685 F.2d 66, 70 (3d Cir. 1982) ("total offset" method is not punitive and therefore may be utilized under the FTCA, 28 U.S.C. 2674) (citing decision in this case).

STATEMENT

Respondent Howard E. Pfeifer instituted this action under Section 5(b) of the Longshoremen's and Harbor Workers' Compensation Act (LHWCA), 33 U.S.C. 905(b), against his employer, petitioner Jones & Laughlin Steel Corporation, for injuries he sustained after falling on the deck of a coal barge owned by Jones & Laughlin (Pet. App. 2a). Pfeifer had previously claimed and received workers' compensation payments under the LHWCA (*id.* at 37a). The district court found that Jones & Laughlin was negligent in its maintenance of the barge and that this negligence was the proximate cause of Pfeifer's injury (*id.* at 2a-3a). Petitioner did not challenge these findings on appeal, but rather asserted that Section 5(a) of the LHWCA pretermitted a negligence action brought by an employee against his employer (*ibid.*). The court of appeals, concluding that it remained bound by this Court's decision in *Reed* v. *The Yaka*, 373 U.S. 410 (1963), held that Section 5(a) "does not bar a suit against an owner *pro hac vice* [of a vessel] who also is an employer liable for compensation" (Pet. App. 4a).[1]

---

[1] The first question presented by petitioner to this Court is whether Section 5(b) permits an employee to bring a third-party negligence action against his or her employer. Although the United States takes no position on this question, we note that legislation currently pending before Congress would

On the issue of damages, Pfeifer contended that the impact of inflation must be considered in calculating his lost future wages, and he therefore submitted evidence regarding anticipated wage increases until his presumed date of retirement (Pet. App. 41a). Rather than estimating the anticipated effects of inflation on Pfeifer's lost earning capacity, however, the district court adopted the "total offset" rule announced by the Pennsylvania Supreme Court in *Kaczkowski* v. *Bolubasz*, 491 Pa. 561, 421 A.2d 1027 (1980), and simply refused to reduce Pfeifer's estimated future earnings to present value, on the theory that inflation would "totally offset" the discount rate (Pet. App. 41a-43a).

The court of appeals affirmed (Pet. App. 1a-16a). The court recognized that, under general federal maritime law, a seaman "injured by the tortious conduct of his employer is entitled to an award of damages commensurate with the nature and extent of his injuries. He is entitled to reimbursement for his loss of earnings, past and prospective; for any impairment of his earning capacity; for medical expenses incurred and to be incurred; and for any other economic loss he may have sustained or is likely to sustain" (*id.* at 13a). The court also recognized that inflation has not "been only a temporary phenomenon on the American scene" (*ibid.*) and must therefore be taken into account in calculating damage awards. Because of the "speculative nature of predicting future inflationary trends" (*id.* at 14a), however, the court concurred in the district court's use of the "total

---

amend Section 5(b) to bar negligence actions brought by shipyard employees against their employers. See S. Rep. No. 97-498, 97th Cong., 2d Sess. 4, 19, 31-33 (1982); 128 Cong. Rec. S9213 (daily ed. July 27, 1982).

offset" method. "The total offset method avoids the danger of speculating as to the future rate of inflation by making what we consider a very sensible accommodation: it assumes that in the long run the effects of future inflation and the discount rate will co-vary significantly with the other" (*id.* at 15a). The court concluded that pragmatic considerations justify the assumption underlying the "total offset" method. " 'Litigators are freed from introducing and verifying complex economic data. Judge[s] and juries are not burdened with complicated, time consuming economic testimony. Finally, by eliminating the variables of inflation and future interest rates from the damage calculation, the ultimate award is more predictable' " (*ibid.*, quoting *Kaczkowski* v. *Bolubasz*, *supra*, 491 Pa. at 583, 421 A.2d at 1038).

SUMMARY OF ARGUMENT

The decision of the court of appeals ignores economic reality and unfairly penalizes defendants by overcompensating plaintiffs for the future effects of inflation. The "total offset" rule adopted below assumes, contrary to all sound economic theory, that the future earning power of a damages award will be completely eroded by inflation. In fact, economic theory indicates that a plaintiff can invest a damages award at a rate of interest that exceeds the expected rate of inflation by several percentage points. Therefore, this "real" rate of return (*i.e.*, the interest earned after compensating for inflation) must be considered by a court in discounting a lump sum damages award to present value.

There are at least two methods by which the impact of inflation on a damages award may be properly ascertained. A court may compute lost future earnings without considering inflation, and then discount that

sum by a factor that also disregards inflation—*i.e.*, the "real" interest rate. Alternatively, a court may calculate the expected impact of inflation on lost future earnings and then discount that inflated sum by the prevailing interest rate. Either approach, contrary to the "total offset" method adopted below, fairly compensates plaintiffs for the effects of inflation without unfairly penalizing defendants.

ARGUMENT

THE "TOTAL OFFSET" RULE ADOPTED BY THE COURT OF APPEALS IS CONTRARY TO SOUND ECONOMIC THEORY AND IS AN INACCURATE METHOD OF CALCULATING THE IMPACT OF INFLATION ON DAMAGES AWARDS

The "total offset" rule adopted by the court of appeals is not supported by sound economic theory and clearly overcompensates a plaintiff for the effects of inflation. While federal courts should not ignore the impact of inflation on damages awards, neither should they adopt a rule that systematically overcompensates plaintiffs and penalizes defendants. As the Fifth Circuit recently noted, "the problem is one of fairness to plaintiffs as well as defendants in the trial process. * * * Quite simply, plaintiffs are to be compensated, by a culpable tortfeasor, but should not be over- or under-compensated. Likewise, defendants found liable should pay no more or less than the amount a plaintiff lost because of the injury." *Culver* v. *Slater Boat Co.*, 688 F.2d 280, 286 (5th Cir. 1982) (en banc).

1. The objective of a compensation award is to "place the plaintiff in the same economic position as would have been his if the injury had not occurred." *Russell* v. *City of Wildwood*, 428 F.2d 1176, 1181 (3d Cir. 1970). See also *Norfolk W. Ry.* v. *Liepelt*,

444 U.S. 490, 493 (1980). Personal injury awards, however, once they have been calculated on the basis of projected lost income and life expectancy, are paid immediately to the plaintiff. *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 286. Because of the "earning power of the money that is presently to be awarded" (*Chesapeake & O. Ry.* v. *Kelly*, 241 U.S. 485, 489 (1916)), this Court has traditionally required that the award be discounted to "present cash value." *Ibid.*; *Norfolk & W. Ry.* v. *Liepelt*, *supra*, 444 U.S. at 494. That is, a court generally awards the plaintiff the amount of money that, if safely invested, will yield the total estimated damages during the time frame of the award. "Consequently, the law traditionally permits introduction of testimony, usually by an expert in financial matters, that the lump-sum should be discounted by a factor equal to the interest rate which could likely be earned on a relatively safe investment by an unsophisticated investor. The total projected earnings are thus reduced to the present cash value." *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 286.[2]

The traditional approach to damages calculation, where a court estimates future income losses based on present earnings and then discounts the resulting sum to present value, works well without further adjustment during periods of economic stability. The plaintiff is assured of receiving fully compensatory damages while the defendant's burden is reduced in proper proportion to the earning power of the sum

---

[2] For example, if a plaintiff's projected lost earnings over ten years were calculated at $10,000 per year or $100,000, courts have not traditionally awarded the plaintiff $100,000, but rather the sum of money that would yield $10,000 per year during the ten-year period of the award. See *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 286-287.

paid to the plaintiff. *Chesapeake & O. Ry.* v. *Kelly*, *supra*, 241 U.S. at 489. Unfortunately, however, the economy in recent years has been far from stable. The traditional method for computing damages awards, moreover, has not always accounted adequately for persistent inflationary trends in the national economy. Some courts have had difficulty estimating future earnings because of inflationary pressures (see, *e.g.*, *Williams* v. *United States*, 435 F.2d 804, 807 (1st Cir. 1970)); a bewildering rise in interest rates has left other courts unsure about proper application of discount rates (see, *e.g.*, *Kaczkowski* v. *Bolubasz*, 491 Pa. 561, 583, 421 A.2d 1027, 1038 (Pa. 1980)). But, while the problems are real, clear solutions are emerging from the lower federal courts.

Accounting for the future effects of inflation on damages awards "is really an economic, and not a legal, problem." *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 286. Faced with the task of adjusting damages awards in an inflationary economy, federal courts have developed several methods for fully compensating a plaintiff without overcharging a defendant.[3] See, *e.g.*, *Culver* v. *Slater Boat Co.*, *supra*; *O'Shea* v. *Riverway Towing Co.*, 677 F.2d 1194 (7th Cir. 1982); *Doca* v. *Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30 (2d Cir. 1980), cert. denied, 451 U.S. 971 (1981); *Steckler* v. *United States*, 549 F.2d 1372 (10th Cir. 1977); *United States* v. *English*, 521 F.2d

[3] The First Circuit apparently stands alone in its refusal to consider the effects of inflation on damages awards, principally on the theory that estimates of future inflation are too speculative to serve as a basis for calculating damages. *Williams* v. *United States*, 435 F.2d 804, 807 (1970). The Fifth Circuit originally took that position (*Johnson* v. *Penrod Drilling Co.*, 510 F.2d 234 (1975) (en banc)), but recently reversed itself in *Culver* v. *Slater Boat Co.*, *supra*.

63 (9th Cir. 1975); *Riha* v. *Jasper Blackburn Corp.*, 516 F.2d 840 (8th Cir. 1975); *Morvant* v. *Construction Aggregates Corp.*, 570 F.2d 626 (6th Cir.), cert. dismissed, 439 U.S. 801 (1978).[4] Unlike the court below, which resorted to the inflexible and wooden "total offset" method, these courts have attempted to "achieve a realistic estimate of future conditions, so that an injured plaintiff can be compensated for his loss as fairly and completely as possible." *Doca* v. *Marina Mercante Nicaraguense, S.A.*, *supra*, 634 F.2d at 38.

2. Although some details regarding proof and trial procedure may differ among the circuits,[5] the courts

---

[4] Three of the above cases, *United States* v. *English*, *Steckler* v. *United States*, and *Riha* v. *Jasper Blackburn Corp.*, did not technically involve federal law damages computation issues. *English* and *Steckler* arose under the Federal Tort Claims Act, in which local law is applied. *Riha* was a diversity case applying Nebraska law. In all three cases, however, the relevance of inflation was considered in light of general principles.

[5] Most federal courts permit expert testimony regarding the anticipated effects of inflation on a damages award. See, *e.g.*, *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 298; *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1200; *Doca* v. *Marina Mercante Nicaraguense, S.A.*, *supra*, 634 F.2d at 39; *Morvant* v. *Construction Aggregates Corp.*, *supra*, 570 F.2d at 632-633; *Steckler* v. *United States*, *supra*, 549 F.2d at 1378; *United States* v. *English*, *supra*, 521 F.2d at 75-76. Some courts permit juries to consider inflation in calculating damages on the theory that inflation "is a fact of life within the common experience of all jurors," but prohibit expert testimony regarding inflation because of the imprecision of such evidence. *Riha* v. *Jasper Blackburn Corp.*, *supra*, 516 F.2d at 845 (based on court's reading of Nebraska state law). This second position is decidedly a minority viewpoint, and apparently has been rejected by the first federal court to have articulated it. Compare *Bach* v. *Penn Central Transportation Co.*, 502 F.2d

of appeals have developed two general approaches in dealing with the impact of inflation upon the present value of lost future wages. Judge Posner's opinion for the Seventh Circuit in *O'Shea* v. *Riverway Towing Co.*, *supra*, and Judge Brown's opinion for the en banc Fifth Circuit in *Culver* v. *Slater Boat Co.*, *supra*, set out in detail these two approaches. Basically, the first method requires a court to "take [inflation] out of both the wages and the discount rate," while the second involves use of a prevailing market discount rate applied "to an estimate of lost future wages that includes expected inflation." *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1199. See also *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d 295-299. Both of these methods adequately compensate a plaintiff for the effects of inflation, and neither exacts an unfair penalty from the defendant.

The first method relies upon what can be termed the "real interest rate." "In layman's terms, the real rate of interest mirrors the rate of interest that lenders would charge in an inflationless society." *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 295.

1117, 1122 (6th Cir. 1974) (permitting jury to consider inflation but excluding expert testimony), with *Morvant* v. *Construction Aggregates Corp.*, 570 F.2d 626, 632-633 (6th Cir.), cert. dismissed, 439 U.S. 801 (1978) (reversing lower court for excluding expert evidence regarding the expected impact of inflation). Whatever the methodology for considering inflationary pressures, however, the courts uniformly require that the damages award be reduced to present value. *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 302-306; *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1200; *Doca* v. *Marina Mercante Nicaraguense, S.A.*, *supra*, 634 F.2d at 39; *Morvant* v. *Construction Aggregate Corp.*, *supra*, 570 F.2d at 631; *Steckler* v. *United States*, *supra*, 549 F.2d at 1378; *United States* v. *English*, *supra*, 521 F.2d at 75; *Riha* v. *Jasper Blackburn Corp.*, *supra*, 516 F.2d at 843.

In reliance on expert economic opinion, the Seventh Circuit has concluded that when no inflation is anticipated, the "real" interest rate is between 1% and 3%. *O'Shea* v. *Riverway Towing Co., supra*, 677 F.2d at 1199. See also *Doca* v. *Marina Mercante Nicaraguense, S.A.*, 634 F.2d at 39 n.10 ("there is substantial opinion that during periods of stable rates of inflation, the real yield of money, whether constant or slightly fluctuating, is approximately 2%"); I. Fisher, *The Theory of Interest* 43 (1930); R. Posner, *Economic Analysis of Law* 78-82 (1973); P. Samuelson, *Economics* 271-273 (9th ed. 1973). Interest rates are higher than this "real" rate only "because of the expectation of inflation and the uncertainty as to its extent." *Culver* v. *Slater Boat Co., supra*, 688 F.2d at 295. The real rate of interest, moreover, presents a fair standard for computing lost future wages during inflationary periods because, as the Seventh Circuit stated, it can be utilized to "take [inflation] out of both the wages and the discount rate." *O'Shea* v. *Riverway Towing Co., supra*, 677 F.2d at 1199.

Under this method, future wages are calculated on the assumption that there will be zero inflation. Then, to be consistent, the "real" interest rate rather than the inflated actual interest rate is applied to that sum to reduce it to present value. Both the Seventh and Second Circuits have suggested use of a 2% discount rate for this purpose. *O'Shea* v. *Riverway Towing Co., supra*, 677 F.2d at 1199; *Doca* v. *Marina Mercante Nicaraguense, S.A., supra*, 634 F.2d at 39. This method adequately compensates a plaintiff for the effects of future inflation because the award will not be invested at a mere 2%, but rather at "the much higher prevailing interest rate." *O'Shea* v.

Riverway Towing Co., *supra*, 677 F.2d at 1199. The difference between the 2% discount rate (*i.e.*, the "real" rate of interest) and the actual prevailing interest rate at which the award will be invested reflects inflationary expectations in the economy and enables the plaintiff to replace lost earnings "with an amount equal to what [he or] she would in fact have earned in that year if inflation continues, as most people expect it to do" (*ibid.*). See also Note, *Considering Inflation in Calculating Lost Future Earnings*, 18 Washburn L.J. 499, 510 (1979) ("Discounting at the real interest rate rather than the nominal interest rate awards plaintiff a lump sum which when invested compensates for future decreases in the dollar's value"). See also *Feldman* v. *Allegheny Airlines, Inc.*, 524 F.2d 384 (2d Cir. 1975).

The second method for dealing with inflationary pressures on lost future earnings differs somewhat in methodology, but not appreciably in result, from the method just outlined. The second method requires a court to calculate lost future wages on the basis of expected inflation, and then discount that amount by a figure that likewise includes expected inflation. Under this method, the plaintiff shows "all of the increases in wages he is likely to receive" during the time period of the damage award. *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 298. "Then, the defendant has the opportunity to establish, by expert testimony or otherwise, the discount rate which reflects the rate of interest in a relatively safe investment, which is applied to the award to reduce it to present value." *Ibid.* Although prediction of future inflation rates may at first appear cumbersome and speculative, this approach does not require "gazing into a crystal ball." *O'Shea* v. *Riverway Towing Co.*,

supra, 677 F.2d at 1199. "The expected rate of inflation can * * * be read off from the current long-term interest rate. If that rate is 12 percent, and if as suggested earlier the real or inflation-free interest rate is only one to three percent, this implies that the market is anticipating 9-11 percent inflation over the next 10 years, for a long-term interest rate is simply the sum of the real interest rate and the anticipated rate of inflation during the term." *Ibid.*

Either of the two preceding methods is an acceptable—and relatively accurate—means of accounting for the impact of inflation on an award of lost future earnings. The first method assumes zero inflation in estimating future lost wages, but likewise assumes zero inflation in reducing the resulting award to present value. The second method allows a plaintiff the opportunity to show just what the predictable impact of inflation on his or her future earnings would be, while allowing the defendant to reduce that calculation to present value on the basis of current, inflated interest rates. Both methods treat the plaintiff and defendant fairly, both are based on sound economic theory, and neither presents insurmountable evidentiary or procedural obstacles for the district courts. See generally *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1199-1200; *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 302-306. See also *Norfolk & W. Ry.* v. *Liepelt*, *supra*, 444 U.S. at 494.[6]

---

[6] We do not suggest that the Court, at this time, adopt one of the above two methods to the exclusion of the other. The law in this area is still developing, and further experience in the district courts and courts of appeals is vital in determining the respective merits of each of the above approaches. See generally *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d 295-

3. In contrast with the above methods, the "total offset" approach adopted by the court below is not founded on any valid economic theory and routinely penalizes defendants by overcompensating plaintiffs for the effects of inflation. See, *e.g.*, I. Fisher, *The Theory of Interest* 43 (1930); R. Posner, *Economic Analysis of Law* 78-82 (1973); Note, *supra*, 18 Washburn L.J. at 509. Moreover, the sole justification for the rule—judicial efficiency—is insufficient to validate its ill effects.

As stated by the court below, the "total offset" rule rests solely on what it termed "a very sensible accommodation" (Pet. App. 15a). The rule "assumes that in the long run the effects of future inflation and the discount rate will co-vary significantly with the other" (*ibid.*). That is, a court applying the "total offset" rule must assume that the inflation rate will totally negate "the earning power of the money that is presently to be awarded." *Chesapeake & O. Ry.* v. *Kelly*, *supra*, 241 U.S. at 489. This "sensible accommodation," however, is clearly irrational, as it proceeds upon the premise that lenders expect no net return on their capital. Such an assumption is contrary to all accepted economic theory. I. Fisher, *The Theory of Interest* 43 (1930); R. Posner, *Economic Analysis of Law* 78-82 (1973).

---

302. Importantly, the federal courts that have addressed these issues have not required inflexible use of one or the other computation methods. *Id.* at 299 n.23; *Doca* v. *Marina Mercante Nicaraguense, S.A.*, *supra*, 634 F.2d at 39; *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1200. There is, moreover, some continuing debate regarding the relative superiority of one or the other of the methods described above. See, *e.g.*, *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 302. Compare *id.* at 311-313 (Hill, J., concurring in part and dissenting in part).

As recognized by courts in at least three circuits, the "risk free" or "real" interest rate "is between one and three percent." *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1199. Accord, *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 296-297; *Doca* v. *Marina Mercante Nicaraguense, S.A.*, *supra*, 634 F.2d at 39. That is, lenders are willing to make loans during periods of zero inflation at between 1% and 3% interest. "Additional percentage points above that level reflect inflation anticipated over the life of the loan." *O'Shea* v. *Riverway Towing Co.*, *supra*, 677 F.2d at 1199. Thus, the future earning power of a damages award is not completely "netted out" or "offset" by inflation—the money can be safely invested at a rate that will compensate for future inflation as well as return a "real" profit of between 1% and 3%. I. Fisher, *The Theory of Interest* 43 (1930); R. Posner, *Economic Analysis of Law* 78-82 (1973).

Because of the clear economic fallacy upon which the "total offset" rule is predicated, no court of appeals had sanctioned use of the rule until the decision of the Third Circuit in this case. See, *e.g.*, *United States* v. *English*, *supra*, 521 F.2d at 75 ("By today's holding that the trier of facts in awarding damages may take into consideration estimated changes in the purchasing power of money, we do *not* mean to imply that the lower court may use our holding as an excuse not to discount an award to its net present value") (emphasis in original). But see *Freeport Sulphur Co.* v. *S/S Hermosa*, 526 F.2d 300, 309-310 (5th Cir. 1976) (Wisdom, J., concurring) (suggesting use of "total offset" method, with the caveat that discounting an award by the "real" rate of interest "would provide more exact compensation"). The Fifth Circuit has noted that the total offset "unnecessarily penalizes defendants because

* * * interest rates on relatively safe investments will typically ride several percentage points above the rate of inflation." *Culver* v. *Slater Boat Co., supra*, 688 F.2d at 299. Even the Third Circuit has recognized that "the total offset method may not conform precisely to economic reality." *Barnes* v. *United States*, 685 F.2d 66, 70 (1982). While the damages calculation methods outlined in section two of this brief may not perfectly account for the impact of inflation in all cases,[7] they do attempt reasonably and fairly to predict the amount of money that will make a plaintiff whole without penalizing a defendant. It is simply "illogical and indefensible" (*O'Shea* v. *Riverway Towing Co., supra*, 677 F.2d at 1200) to require a defendant to pay the entire, undiscounted lump sum of estimated lost future earnings on the erroneous assumption that inflation will totally cripple the earning power of that award. This Court's vintage precedent in *Chesapeake & O. Ry.* v. *Kelly, supra*, requires reversal of the decision below, because a federal court may not totally disregard the "earning power" of a damages award. 241 U.S. at 489.[8]

---

[7] Discounting by the "real" rate of interest may not be as precise as adjusting future income in light of anticipated inflation and then discounting by the prevailing market interest rate. See, *e.g.*, *Culver* v. *Slater Boat Co., supra*, 688 F.2d at 296-298, 302; Note, *supra*, 18 Washburn L.J. at 507 n.114.

[8] Contrary to the assertion of the court below, the "total offset" method does not "bid[] fealty to the concept of reducing future earnings to present worth" (Pet. App. 15a). Instead, the method assumes as a matter of law that inflation completely cancels out the future earning capacity of a damages award. Such an assumption not only flies in the face of all sound economic theory (Note, *supra*, 18 Washburn L.J. at 509), it is a matter particularly inappropriate for resolution as a question of law. As noted by the Fifth Circuit, adjusting an award to compensate for the effects of inflation

The sole justification advanced by the court below for the "total offset" method is the fact that it contributes to " 'judicial efficiency' " (Pet. App. 15a, quoting *Kaczkowski* v. *Bolubasz*, *supra*, 491 Pa. at 583, 421 A.2d at 1038). But freeing judges, juries and litigators from sometimes complicated economic calculations does not validate the patent unfairness of the "total offset" method. In *Norfolk & W. Ry.* v. *Liepelt*, *supra*, 444 U.S. at 494, the Court wrote that "future inflation" was a matter of "estimate and prediction" that "might provide the basis for protracted expert testimony and debate." Nevertheless, this fact alone is not sufficient to preclude judges and juries from considering and utilizing such evidence. "[T]he practical wisdom of the trial bar and the trial bench has developed effective methods of presenting the essential elements of an expert calculation in a form that is understandable by juries that are increasingly familiar with the complexities of modern life." *Ibid.* Inflation is one of the "complexities of modern life" with which judges and jurors have indeed become increasingly familiar during recent years. The pragmatic consideration of judicial efficiency—while of some importance—does not justify adoption of a rule of law that ignores economic reality solely to avoid presenting judges and juries with "the essential elements of an expert calculation" (*ibid.*).[9]

"is really an economic, and not a legal, problem." *Culver* v. *Slater Boat Co.*, *supra*, 688 F.2d at 286. Even assuming, arguendo, that economic conditions in 1982 result in inflation completely offsetting the earning power of capital, a court would hardly be justified in concluding that such an unusual scenario will continue indefinitely, regardless of future factual developments.

[9] The "total offset" method, moreover, does not make calculation of a damages award " 'more predictable' " (Pet. App.

Far from an analysis that is "coherent and consistent with the elements of damages discussed in previous case law" (Pet. App. 15a), the "total offset" method is in reality a rigid, wooden, per se rule that ignores both theoretical and actual economic conditions. It must, therefore, as a matter of fairness, be rejected by this Court. "[A]ny standard which is inflexible in a dynamic economy will likely be unable to cope with the problem of preventing windfalls either to plaintiff or defendant. Although a perfect method may never be found, we must attempt to create standards that are fair to both sides of the controversy * * *." *Culver* v. *Slater Boat Co., supra,* 688 F.2d at 300.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

REX E. LEE
Solicitor General
J. PAUL MCGRATH
Assistant Attorney General
KENNETH S. GELLER
Deputy Solicitor General
RICHARD G. WILKINS
Assistant to the Solicitor General
JEFFREY AXELRAD
Attorney

NOVEMBER 1982

15a, quoting *Kaczkowski* v. *Bolubasz, supra,* 491 Pa. at 583, 421 A.2d at 1038). The approach "ignores rather than enhances predictability. As no sound economic theory supports total offset, the [total offset method] fails to resolve the speculation inherent in economic forecasting." Note, *supra,* 18 Washburn L.J. at 509 (footnotes omitted).

☆ U. S. GOVERNMENT PRINTING OFFICE: 1982 382443 1186